United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

76-
75-7058

ORIGINAL

To be argued by
BENEDICT GINSBERG

B

In The

United States Court of Appeals

For The Second Circuit

P/S

CY SEYMOUR,

Plaintiff-Appellee,

vs.

BACHE and COMPANY, Incorporated, and ALEX CANAAN,

Defendants-Appellants.

BRIEF FOR DEFENDANT-APPELLANT

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CY SEYMOUR,

Plaintiff-Appellee,

-against-

Docket No.:
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BACHE & CO., INC. and ALEX CANAAN,

Defendants-Appellants.

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BRIEF ON BEHALF OF APPELLANT BACHE & CO., INC.

Statement

This appeal presents two questions of first impression. They arise in the following context.

The plaintiff has been actively trading in the stock market for many years. The individual defendant (hereinafter Canaan) has been the plaintiff's "customer's man" during all those years. During part of that time Canaan was employed by the corporate defendant (hereinafter Bache) and at other times, by others. The plaintiff followed

Canaan, as his customer, as Canaan moved from one brokerage firm to another.

After Canaan returned to the employ of Bache, bringing the plaintiff with him as a customer, the plaintiff entered into an agreement with Bache, dated June 4, 1973 (31a) which contained a general arbitration clause.

All of the acts complained of by the plaintiff occurred prior to June 4, 1973. Specifically, the acts complained of relate to "620 separate securities transactions" consummated during the period "from July 22, 1969 to July 1, 1972" (complaint, paragraph NINETEENTH, Record, page 18a).

In essence plaintiff contends that Bache did not adequately supervise Canaan. The acts complained of constitute a common law cause of action against Bache. Plaintiff also alleges that the same acts constitute a violation of the Exchange Act of 1934.

The affidavits in support of the Bache motion to stay the action on the grounds of an existing valid agreement to arbitrate all disputes between the parties, are not controverted. The plaintiff submitted no affidavit in

opposition to the Bache motion below.

The questions of first impression presented by the Record are:

1. A party cannot be compelled to arbitrate claims based on alleged violations of the Securities Act, when the violations occurred after the agreement to arbitrate was made. May a party be compelled to arbitrate where the alleged violations occurred before the agreement to arbitrate was made?

2. Where a cause of action accrued before an agreement to arbitrate was made, may a party to the agreement resist arbitration on the ground that although all of the facts upon which the cause of action is based, were known to him at the time he made the agreement to arbitrate, he had not been advised by counsel that those facts constitute an actionable claim?

The Facts

The plaintiff opened a securities account with the defendant Bache on or about July 1, 1969. The defendant Canaan was the employee at Bache who handled plaintiff's account.

In June of 1972 Canaan left the employ of Bache and went to work for another brokerage firm. The plaintiff closed his account with Bache and opened an account with Canaan's new employer where plaintiff continued actively to trade in securities for approximately one year; June 30, 1972 to May 1, 1973. The plaintiff again became a customer of Bache, on June 4, 1973 when Canaan again became an employee of Bache.

When the plaintiff originally opened his account at Bache, and when he again resumed the customer relationship with Bache, after the lapse described above, the plaintiff entered into standard New York Stock Exchange margin agreements. The first one was executed on December 15, 1970; the second, on June 4, 1973. Both margin agreements contain the following provision:

> "This contract shall be governed by the laws of the State of New York...any controversy arising out of or relating to my account, to transactions with or for me or to this agreement or the breach thereof, shall be settled by arbitration in accordance with the rules then obtaining of either the American Arbitration Association or the Board of Governors of the New York Stock Exchange, as I may elect..."

The plaintiff alleges in his complaint that defendants were guilty of virtually every violation of § 10 (b) of the Securities and Exchange Act of 1934, [15 U.S.C. § 78j(b)] and of Rule 10b-5 promulgated thereunder, [17 C.F.R. § 240.10b-5,] as well as the breach of the common law obligations of a fiduciary.

"The gravamen of the action is 'churning'" (opinion of Tenney, J.) (34a). The plaintiff's complaint identifies the acts complained of as "620 separate securities transactions in plaintiff's security accounts for total purchases amounting to approximately $2,393,000.00 and total sales of approximately $2,252,000.00", those acts are alleged to have occurred between July 22, 1969 and July 1, 1972. The Court will note that (a) many of the acts complained of occurred at a time when plaintiff's securities dealings were being transacted through a brokerage firm

other than Bache and (b) that the June 4, 1973 agreement was executed almost a full year after all of the acts complained of had occurred.

Questions Presented

1. Does the Securities Act of 1934 permit a plaintiff to avoid his contractual obligation to arbitrate even though the acts complained of occurred prior to the execution of the agreement to arbitrate.

The Court's Answer: Yes.

2. Does the holding in Wilco v. Swan, 346 U.S. 427 (1953), which held that arbitration agreements are unenforceable in actions involving violations of the Securities Exchange Act of 1933, where the arbitration agreement was executed prior to the alleged wrong, control the case at bar, where the agreement to arbitrate was entered into after the wrongs were committed, and where the wrongs constitute a common law cause of action, but are also alleged to be violations of the Securities Exchange Act of 1934?

The Court's Answer: Yes.

POINT I

THE PLAINTIFF HAD FULL KNOWLEDGE OF ALL FACTS THAT ARE ALLEGED TO BE THE BASIS OF HIS CLAIM, PRIOR TO HIS EXECUTION OF THE AGREEMENT TO ARBITRATE DATED JUNE 4, 1973

The complaint states that the plaintiff's account was "churned" to the extent of "620 separate securities transactions in plaintiff's security accounts for total purchases amounting to approximately $2,393,000.00 and total sales of approximately $2,252,000.00" prior to July 1, 1972. Since the second arbitration agreement was signed by the plaintiff on June 4, 1973 and since the plaintiff offered no affidavit to the Court below to the effect that the defendants or anyone else kept the facts from him or that he failed to receive, read or understand his statements and customer confirmations, the record is therefore clear, beyond a shadow of a doubt, that the plaintiff was aware of those facts approximately one year before he signed the second arbitration agreement.

POINT II

IN ORDER TO FIT THIS CASE WITHIN THE SCOPE OF WILCO v. SWAN THE COURT BELOW IGNORED THE FACTS AND MISAPPLIED THE LAW

Judge Tenney's opinion acknowledges that if the plaintiff had agreed to waive his rights under the Securities Act of 1934, he could do so, provided it was not a waiver that operated *in futuro*.

Judge Tenney avoided the inescapable conclusion that when the plaintiff signed the second arbitration agreement, he knew all of the facts upon which his complaint is based, by the fiction of artificially dividing the plaintiff's relationship with Bache into two parts. The first part was fixed as the period from the inception of the account, July 1, 1969 to the date preceding the execution of the second arbitration agreement, to wit, June 3, 1973. This period would be deemed to be covered by the arbitration agreement signed in 1970, and could thus be construed to act as a waiver *in futuro*.

The second part of plaintiff's relationship with

Bache would be deemed to run from June 4, 1973 (the date of the second arbitration agreement) onwards; and thus contrued, it could not be treated as an agreement to arbitrate past acts, but only as a waiver *in futuro*.

Judge Tenney held that the second arbitration agreement could not apply to the first part of plaintiff's relationship with Bache, thereby placing the defendant in a "Catch 22" situation. According to Judge Tenney, each time a customer signs a new margin agreement, a new relationship has occurred, and the new arbitration agreement is not applicable to past acts. Since the arbitration agreement, to be enforceable, must, according to *Wilco v. Swan*, apply only to past acts, the defendant is "snookered".

Not only is this illogical, but it completely ignores the fact that the second arbitration agreement, states, quite specifically, that it applies to "...all my accounts in which I have an interest...which I *have* opened, or will open in the future..." (31a) (underlining mine).

Actually, plaintiff's relationsip with Bache

is one which is divisible, if at all, into four parts:

1. The period from July 1, 1969 when plaintiff became a customer of Bache, until June, 1972, when he closed his account.

2. The period from June, 1972 until May, 1973 when the plaintiff was the customer of another broker and initiated no transactions through Bache.

3. The period from May 1, 1973 until June 3, 1973 when the plaintiff was again a customer of Bache.

4. The period June 4, 1973 when plaintiff executed the second agreement to arbitrate "any controversy" with Bache, relating to "...all my accounts in which I have and interest...which I have opened, or will open in the future...".

POINT III

WILCO v. SWAN DOES NOT CONTROL THE CASE AT BAR

As a general rule, a case stands only for its facts. A holding in a case similar should not control, but may indicate a direction for a similar case, if that case has, independantly, the facts and the law to warrant the similar result.

The case of Wilco v. Swan involved a customer of Hayden Stone, a stockbrokerage house, who when he opened his account, signed a margin agreement containing an arbitration provision together with a provision that the broker was not responsible for false representations or advice. The Supreme Court reversed the lower courts and ordered that arbitration be denied. The Court reasoned that the margin agreement was an attempt by the defendant to obtain a waiver from the plaintiff, in futuro, of his rights under the Securities Act of 1933.

The Court further held that the reason that the agreement to arbitrate was void, was that it constituted a prohibitive waiver of § 12(2):

> "To effectuate this policy, Section 12(2) created a special right to recover from misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter" Wilco v. Swan at supra.

The case at bar does not fall within the scope of Wilco v. Swan.

The action here involves only violations of the common law and of the Securities Act of 1934. This is important because the very section that Wilco v. Swan held was the non-waiverable provision, to wit, § 12(2), does not appear in the act of 1934.

Until the case of Sherk v. Alberto-Culver Co., 417 U.S. 506, the District Courts had applied the rule in Wilco to cases brought to remedy violations of the Securities Act of 1934 as well as of the Securities Act of 1933.

However, in the case of Sherk, the Supreme Court distinguished between the two Acts, which distinction should guide this Court.

Although Sherk was decided on grounds other than those that would require a direct overruling of Wilco v. Swan, it is clear that at long last the Supreme Court has given an indication that the differences between the two Acts are not to be ignored.

The Court said in Sherk:

> "There is no statutory counterpart of Section 12(2) in the Securities Exchange Act of 1934, and neither Section 10(b) of that Act nor Rule 10b-5 speaks of a private remedy to redress violations of the kind alleged here. While Federal case law has established that Section 10(b) and Rule 10b-5 create an implied private cause of action, see 6 L. Loss, Securities Regulation 3869-3873 (1969), and cases cited therein; cf. J. I. Caseco v. Borack, 377 U.S. 246, 12 L. Ed.2d 423, 84 S. Ct. 1555, the Act itself does not establish the 'special right' that the Court in Wilco found significant." Sherk v. Alberto-Culver, at 413-414.

The case at bar also differs from the Wilco case in that the plaintiff here had knowledge of the facts as outlined in Point I, while the issues in Wilco concerned a waiver "prior to any violation of the Securities Act", Wilco v. Swan, 346 U.S. at 435.

According to the Record herein, the arbitration agreement was clearly subsequent "to violations of the Securities Act".

CONCLUSION

The plaintiff should be directed to arbitrate his claims against the defendants pursuant to the agreement to arbitrate.

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Bache & Co., Inc.

With him on the Brief
CHARLES E. RAMOS

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UNITED STATES COURT OF APPEALS:2nd CIRCUIT

CY SEYMOUR,

Plaintiff-Appellee,

- against -

BACH/E and COMPANY, Incorporated, and ALEX CANAAN,

Defendants-Appellants.

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Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF *ss.:*

I, James A. Steele *being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at* 310 West 146th Street, New York, New York

That on the 30 *day of* March *1976 at* **600 Madison Avenue** **225 Broadway**

deponent served the annexed Brief *upon*

Paul R. Scott attorney for Lipkin and Weissberg attorneys for Appellant, Canaan **Appelle**

the *in this action by delivering a true copy thereof to said individual personally. Deponent knew the person so served to be the person mentioned and described in said papers as the* *herein.*

Sworn to before me, this 30 *day of* March *19*76

Robert T. Brin

ROBERT T. BRIN
NOTARY PUBLIC, State of New York
No. 31-0418950
Qualified in New York County
Commission Expires March 30, 1977

James A. Steele

JAMES A. STEELE